

N O. 2 2 1 1 8 - A
IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ANGELUS FUNERAL HOME,

Petitioner,

vs.

COMMISSIONER OF INTERNAL
REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF

PETITION TO REVIEW A DECISION
OF THE TAX COURT OF THE UNITED STATES

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TABLE OF AUTHORITIES

<u>Cases</u>	<u>Page</u>
Bremerton-Tacoma Stages v. Squire (W. D. Wash. , 1951), 96 F. Supp. 718	10
C. I. R. v. Dill Company (C. A. 3, 1961), 294 F. 2d 291	10
C. I. R. v. Riss (C. A. 8, 1967), 374 F. 2d 161	9
Clinton Hotel Realty Corp. v. C. I. R. (C. A. 5, 1942), 128 F. 2d 968	9
Consolidated-Hammer Film Co. v. C. I. R. (C. A. 7, 1963), 317 F. 2d 829	10
Harcum v. United States (E. D. Va. 1958), 164 F. Supp. 650	9
Kitchin v. C. I. R. (C. A. 4, 1965), 340 F. 2d 895	10
Mantell v. C. I. R. (1952), 17 T. C. 1143	9
Portland Cremation Association v. C. I. R. (C. A. 9, 1929), 31 F. 2d 843	7, 8, 9, 12
Summit Coal Co. v. C. I. R. (1930), 18 B. T. A. 983	10
Veenstra & De Haan Coal Co. (1948), 11 T. C. 964	10
Virginia Iron, Coal and Coke Co. v. C. I. R. (C. A. 4, 1938), 99 F. 2d 919	10
Warren Service Corp. v. C. I. R. (C. A. 2, 1940), 110 F. 2d 723	9
Woodlawn Park Cemetery Co. v. C. I. R. (1951), 16 T. C. 1067	10
Zaconick v. McKee (C. A. 5, 1962), 310 F. 2d 12	9

Statutes

Page

California Business & Professions Code:

§7736

6

§7738

6

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The exchange of Petitioner's Opening Brief and Respondent's Brief at bar makes clear the narrow, sole issue of law dividing the parties.

The case reduces simply to this: During the 1961 tax year ^{1/} petitioner Angelus Funeral Home received -- concededly under and pursuant to a written instrument of trust, entitled "Pre-Need Funeral Plan Agreement" (Petr's Ex. 11) -- advance

^{1/} Strictly speaking, during the portion of the 1961 tax year commencing in September, 1961 (T.R., Vol. I, pp. 31 et seq). Hereafter, for purposes of brevity, all references to "the 1961 tax year" will be intended to refer to the portion of that year commencing in September, being the only period of tax liability in issue on this appeal.

cash payments to be applied on the applicant's death to furnish-
ing agreed funeral services and a casket, or to be returned to
the designee of the applicant's family should death occur outside
Los Angeles County where funeral services by Angelus would
"not [be] practicable" (Id., par. 7). By its terms the written
instrument of trust required Angelus as trustee to hold the
advance payments until the applicant's death "in irrevocable trust"
(Id., par. 4).

Thus it is undisputed that the taxpayer during the 1961
tax year received the advance cash payments contended by the
Commissioner on this appeal to be taxable income, but it is
equally undisputed that these moneys were received by the tax-
payer not as an ordinary cash recipient but as the trustee under
a valid, fully signed and executed written instrument of trust.

Moreover, although the taxpayer is the trustee under the
written trust and although the subject matter of the trust is of
interest and benefit to the taxpayer as well as to the funeral
applicants as the trust beneficiaries, and although any income
from the trust during its life is awarded by the trust document to
the taxpayer as the equivalent of reasonable trustee fees (the
amounts in each individual trust being small, and the bookkeeping
and administrative work being proportionately substantial), it is
admitted by the Commissioner, and is established as the law of
the case, that none of these features, either separately or
collectively, destroy the trust character of the holdings or make
the same taxable as income to the taxpayer upon receipt. This

because all of these features equally characterized -- indeed, in identical words -- the parallel written trust document (Petr's Ex. 10) under which the taxpayer received prior moneys in identical circumstances for the earlier tax years of 1959 and 1960 for which years the trial court's holding below that the moneys received were valid trust holdings, not taxable as income to the taxpayer, is now a final judicial holding at bar in consequence of the Commissioner's failure to appeal therefrom.

The sole distinguishing feature separating receipts under the trust document used during 1961, the tax year in issue on this appeal, from the prior concededly trust-protected receipts under the trust document used in the earlier tax years 1959 and 1960, is a change in the language as to trustee-powers allowing Angelus under the amended trust document to invest the trust moneys -- still explicitly to be held "in irrevocable trust" -- in real property and improvements rather than solely in bank deposits, as previously required. ^{2/}

The Commissioner urges that this single change in trust powers so converted the taxpayer's status as to render taxable the trust-held moneys otherwise concededly immunized from present income-tax liability. The Commissioner urges no special case authorities but relies instead upon the general principles of

^{2/} Specifically, under the 1961 trust document Angelus, as trustee, is granted power to use trust moneys "as collateral or payment for (i) the costs of any capital improvement to then existing mortuary facilities belonging to ANGELUS, and (ii) the acquisition and improvement of real property" (Petr's Ex. 11, par. 5).

the "claim of right doctrine" (Resp. Br. 9 and 15). The Commissioner urges that the taxpayer under the 1961 trust document could use the trust moneys "for purposes beneficial to it (acquisition or improvement of land)" (id., p. 10), albeit only within prescribed limits and only during the trust period, and contends that Angelus' essential status was thus made akin to that of a cash recipient receiving money "under a claim of right and without restriction as to its use" (Resp. Br. 15). The trust document, says the Commissioner, was in such circumstances rendered "meaningless" and a "facade" (Id., p. 16).

Taxpayer does not quarrel with the claim of right doctrine but contends it is inapplicable here.

The Commissioner freely concedes that for the claim of right doctrine to apply the money must be received "without restriction as to its use" (Resp. Br. p. 15) and concedes that "receipts by a trustee . . . are not income to the trustee" (Id., p. 16). Specifically, the Commissioner concedes apropos the instant case that "[a] prepayment for future services which the taxpayer-payee is prohibited from using as its own, but must hold in trust until the services are performed, is not reportable until the restriction on its use disappears, i. e., until the services are performed and the trust is thereby terminated." (Id., p. 16).

Beginning with these concessions, and with the law of the case that the trust subject matter and the taxpayer's position as trustee and all other of the unchanged trust provisions do not militate against the tax-immunity of the trust, taxpayer contends

that under elementary trust law -- fully accepted and enforced in the law of California where the trust at bar is to be administered -- the trust power complained of by the Commissioner, despite the reach of its abstract terms, would be narrowed, confined and construed by a court of equity so as to preserve and protect fully the trust purposes and the interests of the beneficiaries. It is taxpayer's contention that under settled judicial trust-law principles a literal power in a trustee to invest trust moneys in a manner potentially benefitting himself as well as, or in lieu of, the trust itself, is subject to strict and narrow construction and to "jealous" judicial restraint and review, to insure that the rights of the beneficiaries will be safeguarded and that the power will be exercised only in "uberrima fides". (See the discussion and the authorities cited in Petitioner's Opening Brief, pages 14-17.)

The Commissioner ignores totally, and makes no response to, these vital trust-law fundamentals which genuinely confine and restrict the taxpayer's powers as a trustee under the trust document in issue at bar. The Commissioner stresses only the bare language of the trust power, contending that the face of the power could embrace liberty to invest in "any" kind of real property, and implying that the taxpayer might invest the trust funds in wasting or high-risk investments to the taxpayer's selfish interest and to the prejudice and risk of the trust and the trust beneficiaries.

But, as indicated above, the effective, stern trust-remedy powers of a court of equity would permit no such abuse. The permitted investments are limited in terms to investments in real

property ^{3/} (an investment form lending itself relatively easily to safeguards and controls to secure the trust interests), and in the premises of the parties (funeral applicants and a funeral-home trustee), considered together with the high public interest and public policy attending and protecting these funeral-deposit relationships (now embodied in newly-enacted California statutes requiring the protection even of independent trustees, but with such protection expressly permitted investments even in mortuary endowment care trust funds ^{4/}), it appears plain that under California law permitted investments under the trust power concerned at bar would be confined by trust principles and public

^{3/} The circumstance that the permitted use of trust funds is a limited use only, is worthy of particular and special note. Under the trust provisions the trust moneys may only be placed in either bank deposits or in real property or improvements thereon. The money may not be used by Angelus to finance or acquire funeral cars, or caskets, or any other form of chattel. Neither may it be used to pay payroll expenses or the costs of advertising or utilities or for any other business expense. Thus its power of use is far less "unrestricted" than the use allowed for an ordinary loan. Yet money received, and used, under a simple loan, or subject to a full or contingent duty to repay, or to produce upon need or demand, according to the terms of a contract or other obligation, whether the duty to repay or to produce upon a future date be fixed, conditional or contingent upon the occurrence of a contingent future event, is concededly not income in a presently-taxable sense. See the cases, excerpts and discussion in Petitioner's Opening Brief at pages 22 -31, and the discussion infra beginning at page 9 et seq., reviewing such material briefly. Note, moreover, that the taxpayer paid a form of interest for its limited right of user at bar. Angelus for such right paid each applicant ten per cent of all sums paid in by the applicant within each calendar year (Petr's Ex. 11, par. 6; R. T. 50-51).

^{4/} California Business and Professions Code, Sections 7736 and 7738, enacted in 1965.

policy to investments in real property undertaken in such form and subject to such reasonable safeguards and securities as to adequately and fairly protect the rights of the trust and the trust beneficiaries and to insure the reasonable liquidity of the trust consistent with its purposes and foreseeable needs. ^{5/} No more could be asked to protect the beneficiaries and the public interest, and no less would equity allow -- and, moreover, an equity court, not the taxpayer, would be the final arbiter.

It does not matter that these limitations on taxpayer's trustee powers are not expressed in the trust document. They are policy-imposed, equity-enforceable judicial limitations, and the test of trust-sufficiency and nontaxability in this income-taxation area, as formulated ably by this Court in the Portland Cremation Association case, is whether under law the trust beneficiaries (here the funeral applicants) would "possess [under the trust document] the right to protect themselves and to demand the preservation of the fund" through the powers and remedies of a court of equity. As this Court said there, and as is equally applicable at bar, "That question is by the authorities answered in the affirmative." (Portland Cremation Association v. C. I. R. (C. A. 9, 1929), 31 F.2d 843, 846.)

To all this the Commissioner makes no response.

^{5/} Indeed, it is undisputed at bar that at all times the taxpayer had a cash reserve, consisting of money on deposit in the trustee accounts maintained pursuant to the trusts here concerned, equal to or exceeding the total amount of its liabilities under all of its "Pre-Need Funeral Agreements" (Joint Tax Court Exhibit 9-I, Schedule I).

Moreover, the Commissioner also fails to meet or distinguish the Portland Cement Association decision as a close case-precedent at bar. The Portland decision holds squarely that a trust for funeral-area care and maintenance is not taxable to the funeral-home trustee, even though the claimed trust there concerned was oral and "inferr[able] from [the] facts and circumstances" only, and hence was far less open and plain than the express, written trust created at bar. (31 F.2d at p. 846.) A trust to provide funeral services is hardly distinguishable from a trust to provide funeral-area care and maintenance, and although the trust in the Portland case was a trust in perpetuity, while the trust at bar is only for a conditional, defined period, the same principles of equity-enforceability, and consequent nontaxability to the trustee, appear equally applicable and dispositive. Shortly put the rule of the Portland decision is that nontaxability turns upon the availability of equitable enforcement powers adequate and effective to confine the trustee to permissible conduct within and consistent with the public-policy trust purposes intended by the parties. Such equitable policing powers exist at bar as fully as upon the facts of the Portland case and in consequence, here as there the public interest favors the validity of trusts for providing future funeral services or funeral-area maintenance and care; on these foundations, nontaxability as to the funeral home-trustee follows as a matter of law. 6/

6/ The Commissioner suggests that nontaxability should be denied at bar out of policy consideration for fear of setting
(continued)

The Commissioner also passes over either without any discussion or with only cursory, passing treatment, the many apt classes of authorities marshalled by petitioner holding that even without express trust limitations where a cash-receiving taxpayer is in fact, by contract or lease or other obligation-source, enforceably required to hold cash received subject to a condition or to a clear uncertainty as to ultimate full right to use the money in fee or as income, no present income taxability can or does arise.

Thus the Commissioner ignores or dismisses merely in passing and without fairly treating or meeting, (1) taxpayer's lease-deposit cases ^{7/} involving lessee deposits which a landlord must hold during the lease period to apply against any covenant-

^{6/} (continued) a precedent which might "open the door" to schemes solely for tax evasion. (Resp. Br. 18). The principles of public policy truly applying, however, are those voiced in the Portland decision favoring the sustaining of private trusts to insure the providence of future funeral services or funeral-area care and maintenance; as to the risk of tax or other abuse the supervisory powers of courts of equity are an adequate guard, and to disallow these private trusts, or to subject them improperly to disabling income taxation, would do a disservice to the public interest as well as to the immediate private parties. The very object of these public-interest trusts is to insure the availability of funds to provide decent burial and funeral services and care at the time of death of the contracting applicants (many of whom are of most humble means as the record at bar discloses) and this purpose should be furthered and safe-guarded by the resources and powers of the law, not frustrated or burdened thereby.

^{7/} The cases concerned here are cited and discussed in Petitioner's Opening Brief at pages 23-26 and include Clinton Hotel Realty Corp. v. C. I. R., 128 F.2d 968; C. I. R. v. Riss, 374 F.2d 161; Zaconick v. McKee, 310 F.2d 12; Warren Service Corp. v. C. I. R., 110 F.2d 723; Harcum v. United States, 164 F. Supp. 650; and Mantell v. C. I. R., 17 T.C. 1143.

breach by the lessee, should any such occur during the leasehold term, with right by the lessor to claim the deposit in fee as rent for the last rental period arising only at the end of the leasehold term when the risk of any possible covenant-violation has expired; these cases firmly hold that such deposits are not taxable to the landlord when paid as present income even without the creation of any express trust, and even though the landlord may be given right to use the deposit moneys freely for any purpose in the interim period, subject only to a duty under the lease to credit the amount of deposit against any covenant breach should any such occur; (2) taxpayer's contract-deposit cases ^{8/} giving similar effect to deposits made under executory sales contracts where the deposits possess "[the] attributes . . . of a loan", rather than the indicia of advance partial payments, or where the deposits are to apply contingently upon possible, but contingent, future sales of goods at prices and upon terms not presently determinable, all of which cases hold such advance deposits are not taxable to the contract recipient at the time received; and (3) taxpayer's option deposit cases ^{9/} treating of deposits paid under contracts or

^{8/} The cases here concerned are discussed in Petitioner's Opening Brief at pages 26-29 and include Consolidated-Hammer Film Co. v. C. I. R., 317 F.2d 829; Summit Coal Co. v. C. I. R., 18 B. T. A. 983; Bremerton-Tacoma Stages v. Squire, 96 F. Supp. 718; Veenstra & DeHaan Coal Co., 11 T. C. 964; and Woodlawn Park Cemetery Co. v. C. I. R., 16 T. C. 1067.

^{9/} These cases are discussed in Petitioner's Opening Brief at pages 29-31 and include Virginia Iron, Coal and Coke Co. v. C. I. R., 99 F.2d 919; C. I. R. v. Dill Company, 294 F.2d 291; and Kitchin v. C. I. R., 340 F.2d 895.

instruments of sale whereunder the option payment is to apply against the sales price if the option is exercised, and whereunder, accordingly, it cannot be told at the time of the option payment whether as to the recipient of the money the payment will ultimately amount to ordinary income (money received for the grant only of an option) or capital gains income (money received as part payment for the sale of a chattel or of land), and if a capital gain, whether a short or a long term capital gain; under these cases it is unvaryingly held that the cash-receiver incurs no income taxability at the time of receipt nor until the ambiguity of the character of the payment is resolved by the acts of the parties.

All of these cases by analogy confirm that moneys received under a genuine contract or other obligation to repay the same (even contingently, as at bar) or under a present uncertainty as to whether the money will ultimately become income at all, or if it becomes income whether it will be ordinary income or capital gains (and within the latter, whether short or long term in character) are not presently taxable to the recipient as income.

The Commissioner makes no responses to any of these cases except to say that the case at bar is not within the factual premises of any of these cited classes of cases. But the decisions concerned here are cited not as direct authorities but as decisions persuasive by analogy. They confirm in principle that money received subject to limitations of use, or subject to contingent obligations to repay the money or to credit its amount against lease or contract violations by the opposing party, or subject to

uncertainties as to its nature and character for taxation purposes, is not presently taxable to the recipient as income. So holding, they illuminate the trust-law issue of taxation at bar, and confirm the propriety of holding under trust law fundamentals and the precedent of the Portland decision that taxpayer, as the trustee of an enforceable, viable trust, incurred no personal income taxation liability on receiving the trust payments put in issue in the case at bar.

Respectfully submitted,
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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ William B. Murrish
WILLIAM B. MURRISH

